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Nos. 86-495, 86-624 and 86-625

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

K MART CORPORATION,
Petitioner,
v.
CARTIER, INC., *et al.*

47TH STREET PHOTO, INC.,
Petitioner,
v.
COALITION TO PRESERVE THE INTEGRITY OF AMERICAN TRADEMARKS, *et al.*

UNITED STATES OF AMERICA, *et al.*,
Petitioners,
v.
COALITION TO PRESERVE THE INTEGRITY OF AMERICAN TRADEMARKS, *et al.*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR PETITIONER K MART CORPORATION

ROBERT W. STEELE *
ROBERT E. HEBDA
Steele & Fornaciari
Suite 850
2020 K Street, N.W.
Washington, D.C. 20006-1857
(202) 887-1779

JAMES C. TUTTLE
Assistant General Counsel
Antitrust and International
K mart Corporation
International Headquarters
3100 West Big Beaver Road
Troy, Michigan 48084
(313) 643-1688

Attorneys for Petitioner K mart Corporation

* Counsel of Record

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
ARGUMENT	2
I. THE STATUTORY SCHEME FAVORS PARALLEL IMPORTS	4
A. Protection Of Trademarks	4
B. Protection Of American Interests	7
C. Regulatory Authority	9
II. BOTH CONGRESS AND THE PUBLIC HAVE LONG RELIED ON THE CUSTOMS SERVICE REGULATIONS	9
CONCLUSION	11

TABLE OF AUTHORITIES

CASES	Page
A. Bourjois & Co. v. Katzel, 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923)	5, 7
Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322 (E.D.N.Y. 1981)	7
Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984)	8
Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911)	2
El Greco Leather Products Co. v. Shoe World, Inc., 806 F.2d 392 (2d Cir. 1986), *rev'g* 599 F. Supp. 1380 (E.D.N.Y. 1984), *petition for cert. filed*, No. 86-1735 (Apr. 27, 1987)	6
Lever Brothers Co. v. United States, 652 F. Supp. 403 (D.D.C. 1987)	3
National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974)	9
NEC Electronics, Inc. v. CAL Circuit Abco, Inc., 810 F.2d 1506 (9th Cir. 1987), *petition for cert. filed*, No. 87-125 (July 20, 1987)	6
Original Appalachian Artworks, Inc. v. Granada Electronics, Inc., 816 F.2d 68 (2d Cir. 1987), *aff'g* 640 F. Supp. 928 (S.D.N.Y. 1986), *petition for cert. filed*, No. 87-38 (July 3, 1987)	6
Prestonettes, Inc. v. Coty, 264 U.S. 359 (1924)	2

STATUTES	
Clean Air Act	
42 U.S.C. § 7401 *et seq.*	4
Fair Packaging and Labelling Act	
15 U.S.C. § 1451 *et seq.*	4
Federal Food, Drug & Cosmetic Act	
21 U.S.C. § 301 *et seq.*	4
Lanham Act	
15 U.S.C. § 1055	3
15 U.S.C. § 1124	*passim*

TABLE OF AUTHORITIES—Continued

	Page
Magnuson-Moss Warranty Act	
15 U.S.C. § 2301 *et seq.*	4
National Traffic and Motor Vehicle Safety Act	
15 U.S.C. § 1391 *et seq.*	4
Tariff Act of 1930	
19 U.S.C. § 66	9
19 U.S.C. § 526	*passim*
19 U.S.C. § 1624	9
Trademark Act of 1905	
Section 27	5
Trademark Counterfeiting Act of 1984	
15 U.S.C. § 1116(d)(1)(B)	6
LEGISLATIVE MATERIALS	
62 Cong. Rec. S 11,605 (Aug. 19, 1922)	8
133 Cong. Rec. H 7,303-7,304 (daily ed. Aug. 7, 1987)	9
133 Cong. Rec. S 11,893-11,894 (daily ed. Sept. 9, 1987)	10
S. Rep. No. 98-526, 98 Cong., 2d Sess. (1984), *reprinted in* 1984 U.S. Code Cong. & Admin. News 3627	6, 10
REGULATORY MATERIALS	
Art. 517, Customs Regulations of 1931	5
1 Fed. Reg. 1,725 (1936) (T.D. 48,537)	5, 8
T.D. 53,399 (1953)	10
19 C.F.R. § 11.14 (1946)	5
19 C.F.R. § 11.14 (1969)	5
MISCELLANEOUS	
COPIAT, *The Economic Impact of Diversion*, submitted to the Customs Service Sept. 20, 1984	3
Wall Street Journal, Aug. 29, 1987, at 2	8

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REPLY BRIEF FOR PETITIONER K MART CORPORATION

K mart submits the following brief in reply to the May 7, 1987 briefs for Respondents and amici, and as a supplement to its February 21, 1987 brief.

ARGUMENT

Respondents argue for a supposedly literal construction of Section 526 which would do something done by no other trademark law (or copyright or patent law) before or since: entitle an enterprise to impose restrictions upon the resale of its goods. Section 526 was intended to protect United States trademark owners against the importation of infringing goods made by others, not to enable foreign manufacturers to control the flow of their own goods after sale.[1]

Even the Respondents tacitly concede that the drafters of Section 526 never envisioned such a drastic result as flowing from their legislative efforts. But based on a twisted interpretation of a rather clear cut legislative intent to prevent trademark infringement by independent foreign companies, Respondents ask the Customs Service to enforce territorial restrictions and price discriminations which are illegal both in the United States[2] and abroad[3]. There is especially no justification for this when Respondents are themselves responsible for the existence of parallel imports:

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[1] As Justice Holmes said in *Prestonettes, Inc. v. Coty*, 264 U.S. 359, 368 (1924), "A trade-mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his." *Cf. Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 409 (1911), holding that once a product has been sold, the public is entitled to the advantage of competition in the subsequent traffic.

[2] The antitrust laws prohibit the price-fixing and other restrictions on domestic distribution which Respondents seek to impose at the point of importation.

[3] Respondents admit that "efforts to stop diversion short of this country's borders are often ineffectual because of the practical or legal difficulty or impossibility of preventing sales in foreign countries to third-party diverters." Respondents' May 7, 1987 Brief at 3. This is because other countries have rejected as illegally anticompetitive Respondents' efforts to restrict parallel imports. *See* foreign cases cited in K mart's February 21, 1987 Brief at 43-44.

COPIAT members manufacture abroad, rather than in the United States, because it is more profitable;

COPIAT members promote the same trademarks and use the same packaging worldwide because it is more profitable;[4]

COPIAT members charge the American consumer higher prices because it is more profitable; and

COPIAT members are owned and/or controlled by foreign companies because it is more profitable.

Respondents have proffered conflicting economic reasons for parallel imports.[5] On the one hand, Respondents claim that expensive warranties and service in the United States account for the cost differences which result in parallel imports.[6] However, COPIAT has submitted statistics to the Treasury Department in connection with the ongoing rulemaking proceeding which show instead that these costs come nowhere near the price difference between "authorized" and parallel imports.[7]

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[4] Respondents claim that import restrictions are necessary because they market inferior products abroad with trademarks, packaging and labelling identical to those on the products they market in the United States. *See Lever Brothers Co. v. United States*, 652 F. Supp. 403 (D.D.C. 1987). The Lanham Act, however, expressly provides that a trademark is forfeited if a related company uses it on an inferior product, thereby deceiving the public. 15 U.S.C. § 1055.

[5] If the result in this case were to depend on such evidence, the case must be remanded for discovery. Cross motions for summary judgment were filed, but no discovery was conducted on the contested issues of material fact (J.A. 2 No. 28). *See* Statement of Robert W. Steele (J.A. 2 No. 28 Att. 8).

[6] *See* Statements of Robert H. Miller ¶ 13, Aaron Altman ¶ 9, Jack M. Abrams ¶¶ 12-18 (J.A. 2, No. 8).

[7] For example, the warranty costs for three camera manufacturers averaged less than 2.7% of the retail price; three fragrance and cosmetic manufacturers had no warranty or service costs whatsoever. COPIAT, *The Economic Impact of Diversion*, submitted to the Customs Service Sept. 20, 1984 at Table 4.

The latter is the more sensible conclusion: Respondents must promote, market, service, and guarantee their products regardless of the country in which they sell them; on the other hand, United States retailers must promote, market, service and guarantee parallel imports at their own expense.[8]

I. THE STATUTORY SCHEME FAVORS PARALLEL IMPORTS

Respondents and their amici would have the Court believe that Section 526 (and Section 42 of the Lanham Act) were actually meant to deal with imagined evils ranging from unsafe automobiles to adulterated liquor. As legislative history and court decisions confirm, these are not the controlling statutes on such matters. Statutes such as the Federal Food, Drug & Cosmetic Act, 21 U.S.C. § 301 *et seq.*, the National Traffic and Motor Vehicle Safety Act, 15 U.S.C. § 1391 *et seq.*, and the Clean Air Act, 42 U.S.C. § 7401 *et seq.*, govern the contents and labelling of cosmetics and the safety and emissions of cars—whether imported or domestic and whether sold by an "authorized" or an "independent" distributor. Likewise, federal and state warranty, labelling and consumer protection statutes, such as the Fair Packaging and Labelling Act, 15 U.S.C. § 1451 *et seq.*, and the Magnuson-Moss Warranty Act, 15 U.S.C. § 2301 *et seq.*, govern the responsibility of retailers, distributors and manufacturers (whether foreign or domestic) for consumer goods.

A. Protection Of Trademarks

Respondents apparently no longer contend that the Customs Service regulations are inconsistent with Section 42 of the Lanham Act. It is certainly difficult to argue that parallel imports violate Section 42, since no

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[8] *See* statements of William Propst ¶ 11, John M. Bauersfeld ¶ 5, Ely Steinfeld ¶ 13 (J.A. 2 No. 28 Atts. 1, 4, 6). For example, K mart spent over $495 million on product promotion in 1986.

"copying or simulating" is involved. Respondents' concession is significant because courts, Congress and the Customs Service have traditionally considered the Lanham Act together with Section 526 when deciding the extent to which the importation of genuine trademarked goods can be prevented. This was the genesis of Section 526, when the Second Circuit held in *Katzel*[9] that the Trademark Act of 1905 did not protect the bona fide purchase of trademark rights by an independent American firm. Since 1922, virtually every congressional[10] and judicial[11] discussion of parallel imports has relied on both Section 526 and Section 42 of the Lanham Act, and the Customs Service has consistently relied on both as the authority for its regulations.[12] For example, the 1936 regulations, which permitted the importation of trademarked goods manufactured abroad where the foreign and domestic trademarks were "owned by the same person, partnership, association or corporation", relied upon both Section 526 and the Trademark Act.[13]

When these two statutes are considered together and construed consistently, the only possible conclusion is that Congress intended trademarked goods to be freely imported except in the very specific *Katzel* situation—to prevent fraud on the independent American purchaser of the domestic rights to a foreign trademark.

The Ninth Circuit recently emphasized the proper application of the Lanham Act to parallel imports.[14] In

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[9] *A. Bourjois & Co. v. Katzel*, 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923).

[10] *See* K mart's February 21, 1987 brief at 24-31.

[11] *See* K mart's February 21, 1987 brief at 1 n.1.

[12] *See* Art. 517, Customs Regulations of 1931 (J.A. 21-22); 19 C.F.R. § 11.14 (1946) (J.A. 45-46); 19 C.F.R. § 11.14 (1969) (J.A. 67).

[13] 1 Fed. Reg. 1,725 (1936) (T.D. 48,537) (J.A. 27-28).

[14] In two cases, the Second Circuit has seriously confused the law of parallel imports by failing to consider the 1984 Lanham Act

NEC Electronics, Inc. v. CAL Circuit Abco, Inc., 810 F.2d 1506 (9th Cir. 1987), the court held that the *Katzel* decision "presuppose[s] the American [trademark] owner's real independence from the foreign manufacturer, and courts interpreting *Katzel* have repeatedly emphasized this factor." 810 F.2d at 1510. The court of appeals also acknowledged that the Customs Service "has *for decades* made an exception to section 526 in cases where the American trademark owner and the foreign producer are under common control." 810 F.2d at 1510 n.4 (emphasis added).

The court further recognized that NEC and its affiliates were themselves responsible for the parallel imports:

> If NEC-Japan chooses to sell abroad at lower prices than those it could obtain for the identical product here, that is its business. In doing so, however, it cannot look to United States trademark law to insulate the American market or to vitiate the effects of international trade. This country's trademark law does not offer NEC-Japan a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark.

810 F.2d at 1511.

Respondents would have this Court endorse such a scheme.

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amendments which defined the indicia of a genuine trademark. *See* 15 U.S.C. § 1116(d)(1)(B). Moreover, the court ignored the legislative history which confirmed the legality of parallel imports. S. Rep. No. 98-526, 98th Cong., 2d Sess. 3 (1984), *reprinted in* 1984 U.S. Code Cong. & Admin. News 3627, 3629. Petitions for certiorari are pending in both *El Greco Leather Products Co. v. Shoe World, Inc.*, 806 F.2d 392 (2d Cir. 1986), and *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 26 (2d Cir. 1987).

B. Protection Of American Interests

Respondents characterize Petitioners' interpretation of Section 526 as xenophobic.[15] But Section 526 by its terms protects only "a citizen of" or "a corporation or association created or organized within" the United States which is also "domiciled in the United States," and the legislative history confirms this bias against foreign companies.[16]

Although Respondents have now proffered a plethora of complex corporate structures to test the limits of the Customs Service regulations, the court below recognized the predominant distribution system at issue:

> This situation typically arises when a foreign producer creates an American subsidiary that then registers the American trademark.

790 F.2d at 904.[17]

To escape antitrust liability for their price-fixing and distributional restraints, COPIAT and its amici argue vigorously that the foreign producer and its American subsidiary are a single entity which cannot conspire with itself.[18] If each of these parent-subsidiary combinations

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[15] The *Katzel* decision itself was xenophobic, since the plaintiff was perceived to have been cheated by the French company from which it purchased trademark rights.

[16] While Congress in 1922 did not envision the complex structure of the modern multinational corporation, there is no reason to assume that it would have favored such an entity over American consumers.

[17] Chief Judge Weinstein described the corporate structure of a COPIAT member as follows:

> Hattori and its American subsidiaries do maintain some independence—about as much as the egg and vegetables in a western omelette.

Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322, 1341 (E.D.N.Y. 1981).

[18] *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984). Respondents alternatively argue that at most they engage in vertical price-fixing, which should no longer be regarded

is a single entity, with a foreign company exercising control, that entity has no right—under the literal words of Section 526—to exclude goods that it has sold abroad. On the other hand, if the domestic subsidiary is considered the agent of its foreign parent, Congress in 1922 stated that parallel imports could not be excluded:

> The mere fact of a foreigner having a trade-mark and registering that trade-mark in the United States through an agency, of course, would not be affected by this provision [*i.e.*, Section 526].

62 Cong. Rec. S 11,605 (Aug. 19, 1922) (statement of Sen. McCumber).[19]

Congress recently confirmed that it considers a foreign manufacturer and its American subsidiary a single entity by refusing to recognize the supposed independence of Toshiba America, Inc., the wholly-owned Toshiba subsidiary which markets consumer electronics in the United States. Congress voted to ban the importation and sale of Toshiba products because one of Toshiba's Japanese subsidiaries, at most a "half-sister" of Toshiba America,

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as *per se* illegal under the antitrust laws. Respondents' May 7, 1987 Brief at 39. This position is questionable both as a matter of law and as a matter of fact.

Recent events confirm that the Customs Service regulations protect American consumers from *horizontal* price-fixing conspiracies. For example, the Electronics Industries Association of Korea, whose members distribute through wholly-owned American subsidiaries, recently announced that it was "voluntarily placing restraints—in the form of price floors—on exports [of consumer electronics products] to the U.S." and would consider imposing export restrictions to keep retail prices high. *Wall Street Journal*, Aug. 29, 1987, at 2. Where an entire industry adopts such a position, parallel imports are the only source of interbrand or intrabrand price competition.

[19] Likewise the Customs Service regulations have, since at least 1936, expressly recognized that Section 526 does not apply where the foreign and domestic trademarks "are owned by the same person, partnership, association, or corporation." 1 Fed. Reg. 1,725 (1936) (T.D. 48,537) (J.A. 27-28).

Inc., had sold secret submarine technology to the Soviet Union.[20]

C. Regulatory Authority

Respondents argue that Congress, in granting general rulemaking authority,[21] did not intend the Customs Service to interpret or construe Section 526, because Section 526 itself contains no delegation of rulemaking authority; on the other hand, where Congress intended the Customs Service to have such authority in particular areas, it made specific, limited delegations of such authority.

This argument has been rejected, perhaps most dramatically in connection with the delegation of rulemaking authority to the Federal Trade Commission. The District of Columbia Circuit held that although Congress had specifically given the FTC rulemaking authority in certain particular areas, this did not preclude the agency from relying on a general delegation of authority to issue broad, substantive rules with the full force and effect of law.[22]

The Customs Service regulations on parallel imports are entitled to similar treatment.

II. BOTH CONGRESS AND THE PUBLIC HAVE LONG RELIED ON THE CUSTOMS SERVICE REGULATIONS

Respondents argue vigorously that the Customs Service regulations are neither long-standing nor consistent. However, at the end, Respondents are forced to admit that a multinational enterprise with both American and foreign arms has not been allowed to preclude importa-

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[20] The Senate voted 95-2 to ban the importation of Toshiba products. House conferees on the Trade Bill were directed to accept such prohibitions to protect national defense. *See* 133 Cong. Rec. H 7,303-7,304 (daily ed. Aug. 7, 1987).

[21] 19 U.S.C. § 66; 19 U.S.C. § 1624.

[22] *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 695-697 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974).

tion of goods bearing a United States trademark since at least 1936.[23] Nor can Respondents point to a single instance when the Customs Service has issued a regulation or public decision supporting their reading of Section 526.

The attacks which Respondents have launched against the various Customs Service regulations in effect since 1936 are largely linguistic. For example, Respondents argue that the Customs Service was somehow inconsistent in 1953 when it amended the regulation expressly to allow admission of trademarked goods manufactured abroad by "related companies".[24] Respondents ignore, however, that the related company language, if it changed the Customs Service regulation at all, *broadened* the class of trademarked goods which could be imported freely into the United States. At no time since 1936 has Customs ever indicated that Section 526 could be the basis for precluding all imports of trademarked goods manufactured abroad by a multinational enterprise.

It is clear that Congress has had this understanding of Customs Service regulations for some time.[25] Indeed, even those legislators who oppose parallel imports are constrained to admit that the Customs Service regulation presently allows such imports.[26]

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[23] While we recognize that Section 526 was directed toward goods manufactured abroad by a foreign company, it should not be construed to permit a United States company to preclude the importation of trademarked goods which its own subsidiary has manufactured abroad. Indeed, such a construction would apparently be contrary to the Lanham Act, which only prohibits the sale of copies, simulations or counterfeits.

[24] T.D. 53,399 (1953) (J.A. 55, 56). *See* Respondents' May 7, 1987 Brief at 44.

[25] *See* S. Rep. No. 98-526, 98th Cong., 2d Sess. (1984), *reprinted in* 1984 U.S. Code Cong. & Admin. News 3627, 3629.

[26] *See* 133 Cong. Rec. S 11,893-11,894 (daily ed. Sept. 9, 1987).

Under the circumstances, American companies which have been dealing in parallel imports have had every right to rely upon the Customs Service regulations. These companies have brought price competition to the market which would not exist if it were not for their reliance and their efforts.

CONCLUSION

Respondents have not advanced any credible reason now to overturn the Customs Service regulations of which Congress has been apprised and on which a substantial domestic industry has relied for over five decades. The rules of statutory construction and considerations of public policy mandate that the regulations be upheld.

For these reasons and those set forth in K mart's February 21, 1987 Brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

ROBERT W. STEELE *
ROBERT E. HEBDA
Steele & Fornaciari
Suite 850
2020 K Street, N.W.
Washington, D.C. 20006-1857
(202) 887-1779

JAMES C. TUTTLE
Assistant General Counsel
Antitrust and International
K mart Corporation
International Headquarters
3100 West Big Beaver Road
Troy, Michigan 48084
(313) 643-1688

Attorneys for Petitioner
K mart Corporation

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* Counsel of Record